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RUEHBU/AMEMBASSY BUENOS AIRES 1492
RUEHLP/AMEMBASSY LA PAZ 2377
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RUEHSP/AMEMBASSY PORT OF SPAIN 3268
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RUEHSG/AMEMBASSY SANTIAGO 3799
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C O N F I D E N T I A L SECTION 01 OF 04 CARACAS 003224

SIPDIS

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ENERGY FOR CDAY, DPUMPHREY, AND ALOCKWOOD
NSC FOR DTOMLINSON

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TAGS: [ECON](#) [ENRG](#) [EPET](#) [EINV](#) [VE](#)

SUBJECT: RECENT DEVELOPMENTS IN THE HYDROCARBON SECTOR

REF: A. CARACAS 03131

[1](#)B. CARACAS 03174

[1](#)C. CARACAS 02881

[1](#)D. 2005 CARACAS 02667

Classified By: Ambassador William R. Brownfield for Reason 1.4 (D)

[1](#)1. (C/NF) SUMMARY: ConocoPhillips received a term sheet on the strategic association migration at roughly the same time as Exxon Mobil and Chevron. The Ministry of Energy and Petroleum (MEP) has made it clear that it does not want state owned oil company PDVSA to operate the strategic associations' upgraders. In addition, it appears that the individual strategic associations will continue to handle the marketing of their syncrude. Venezuela is actually cutting production to some degree as part of OPEC production cuts. Venezuela is importing gasoline components due to shortages. Refinery problems and scheduled maintenance are expected to significantly reduce both gasoline and diesel exports in 2006 and 2007. Recent unrest in the port of Guiria has had an adverse impact on ConocoPhillips Corocoro offshore project. The China National Petroleum Corporation (CNPC) is livid due to the BRV's recent decision to stop production of Orimulsion. END SUMMARY

STRATEGIC ASSOCIATION MIGRATION

[1](#)2. (C/NF) ConocoPhillips (CP) Venezuela President Roy Lyons (strictly protect throughout) met with the Ambassador on October 25 to discuss a variety of issues, including the migration of the strategic associations to joint ventures in which PDVSA holds a majority stake. Lyons' comments on the migration echoed those of his colleagues at ExxonMobil and Chevron (Reftel A). CP has received a terms sheet but does not plan on offering the BRV a counterproposal. Its position is that the strategic associations are based on valid agreements that have been approved by the National Assembly.

¶3. (C/NF) Although Lyons did not get into the specifics of CP's term sheet, he did state that senior CP executives specifically asked Energy Vice Minister Bernard Mommer if CP was still welcome in Venezuela. Mommer replied that CP was not only welcome but that the BRV hoped that it would substantially increase its investments in Venezuela. Lyons noted that CP is not interested in increasing its investments in Venezuela until it has a clear idea of the Venezuelan legal and regulatory framework. He stated that CP did not even purchase a technical package in the current Delta Caribe gas round.

¶4. (C/NF) Lyons noted that CP has already lost substantial value in Petrozuata (CP 50.1%, PDVSA 49.9%) and Hamaca (CP 40%, Chevron 30%, PDVSA 30%) strategic associations as a result of changes in tax and royalty rates as well as new taxes. If the relatively new science and technology tax (two percent of gross revenues) and drug tax (one percent of net revenues) are treated as discretionary expenses, discretionary expenses at one of the strategic associations has risen from 350,000 USD in 2003 to 64 million USD in 2006.

¶5. (C/NF) Lyons stated the MEP and PDVSA do not appear to be communicating with each other and that there appears to be tension in their relationship. Vice Minister Mommer stated to CP executives in front of a senior PDVSA official that he did not want PDVSA operating any of the strategic association upgraders. When asked by the Ambassador if PDVSA could run the upgraders, Lyons replied that they did not have sufficient personnel to do so. Fernando Avila, CP's Legal Manager, (strictly protect throughout) added that Petrozuata

CARACAS 00003224 002 OF 004

uses CP coker technology. If CP was forced out of Venezuela, PDVSA within two years time would find itself in a position where it would have to ask CP for technical assistance.

¶6. (C/NF) Lyons noted that recent industry press reports have stated that PDVSA would take over the marketing of the strategic association's production. He said the reports were false and that the individual associations were still handling all of the marketing. Avila added that the supply contracts between the strategic associations and U.S. refineries were still very much in place.

¶7. (C/NF) COMMENT: Lyons did not offer an opinion on splitting the strategic associations' upgraders from the fields that supply them (Reftel A). In a presentation for the Ambassador on October 19, ExxonMobil Venezuela President Tim Cutt (strictly protect) stated the placement of the fields in a separate entity would greatly decrease the upgraders' operational efficiency. Daily operations require the operators of the upgrader to maintain constant contact with the fields and adjust production levels. Cutt stated Vice Minister Mommer does not appear to understand the upgraders' operations and does not take operational issues into account when discussing the strategic associations' migration to joint ventures. END COMMENT.

OPEC CUTS ARE REAL

¶8. (C/NF) On the subject of OPEC production cuts, Lyons confirmed press reports that the strategic associations have been asked to cut production. Avila stated CP received a letter from the MEP on October 5 with a request to cut production by 1.6 percent. The production cut was retroactive to October 6. Lyons stated the production cut request was delivered prior to the OPEC meeting so that Venezuela could clearly establish that it was serious about cutting production.

¶9. (C/NF) COMMENT: Recent press reports have questioned whether Venezuela was actually going to cut production in order to meet OPEC requirements or merely cut production on

paper. Since Venezuela's actual production is below its OPEC quota as well as its claimed production, there were rumors that Venezuela would lower its claimed production figure without actually cutting production. Based on Lyons' statement as well as a conversation that Petroleum Attache (Petatt) had with oil analysts on October 24, it appears that Venezuela is actually cutting production to some degree. Whether Venezuela fully complies with the announced production cuts remains to be seen. END COMMENT

GASOLINE IMPORTS AND EXPORTS

¶10. (C) According to shipping contacts, the Venezuelan domestic market currently has a gasoline deficit of 100,000 barrels per day. The deficit is due to the low service factor of cat crackers in PDVSA's refineries. (Note: Crackers split large heavy hydrocarbon molecules into smaller, lighter components using very high temperatures and pressure. Depending on the type of cracker, they can also use catalysts to improve the efficiency of the process. END NOTE) As a result of the low service factor, PDVSA gasoline exports dropped by half in the first half of this year to 40,000 barrels per day. In the third quarter, they dropped to 24,000 barrels per day and are expected to drop to zero this month. PDVSA imported 45,000 barrels of gasoline components to support the export of 40,000 barrels of finished gasoline in the first half of the year. Imports of gasoline

CARACAS 00003224 003 OF 004

components are expected to remain at the same level in October and November in order to supply the domestic market.

¶11. (C) PDVSA is currently importing 15,000 barrels per day of MTBE, a gasoline blending component that increases octane. PDVSA does not have a supply contact for MTBE and buys it on the spot market from traders. It began using MTBE in its gasoline when it phased out leaded gasoline in May 2005. PDVSA was supposed to replace MTBE with ethanol in domestic gasoline but its ethanol program has been a failure. After one year, PDVSA is using just 1,000 barrels of ethanol a day in eastern Venezuelan gas blends. The goal was 25,000 barrels per day but the shipping contacts stated the goal would not be reached in the next two years.

¶12. (C) Shipping contacts believe that gasoline exports may rise to eight to ten cargoes in December assuming the cat crackers are back to normal. However, they expect gasoline exports to fall to two to three cargoes per month in the first quarter of 2007 due to problems with the Cardon cat cracker. Scheduled maintenance in the second quarter will also have a significant impact on production at Cardon. Diesel production is expected to be reduced at Cardon in the second quarter of 2007. Cardon supplies diesel to the Caribbean (the Dominican Republic and Cuba among others) as well as the domestic market.

¶13. (C) It is not clear if PDVSA will be forced to import finished gasoline rather than components this year as a result of refinery problems. Oil analysts told Petatt on October 24 that the gasoline deficit and the MTBE import figures look credible. They also stated traders told them that Venezuela is importing gasoline from Iran. Although gasoline imports from Iran do not make any sense economically, the analysts believe the BRV is importing from Iran in order to hide the imports from the market. If PDVSA purchased gasoline in the United States, it would be highly embarrassing for the BRV.

¶14. (C) According to the oil analysts, PDVSA Vice President for Refining Alejandro Granado's star has fallen rapidly within MEP and PDVSA as a result of the refinery problems. The analysts stated Granado is the most senior PDVSA vice president and was considered to be the leading internal candidate for the PDVSA presidency. The analysts stated MEP Minister and PDVSA President Rafael Ramirez now prefers

Eugenio Del Pino as his successor to the PDVSA presidency. COMMENT: Rumors have been flying for months that Ramirez is going to step down from the PDVSA presidency but remain as MEP Minister. It is little wonder that Granado's star has waned. According to Econ specialist's calculations, PDVSA has had 17 major refinery accidents to date in 2006. Eight workers have died as a result of the accidents. The primary cause for the accidents was human error. END COMMENT

RAMPAGING FISHERMEN

¶15. (C) Recent unrest on the part of fishermen in the port of Guiria (Reftel B) has had a significant impact on CP's Corocoro project, an 85 million USD offshore project. CP uses Guiria as a supply base for Corocoro. Rioters burned two CP vehicles and ransacked its office. CP was forced to stop drilling but has since resumed operations. However, the continuing blockade of the port by fishermen has caused CP a number of operational headaches. Replacement crews could reach the work site by speed boat from Guiria in four hours. As a result of the problems in Guiria, they now need sixteen to reach the site.

CARACAS 00003224 004 OF 004

¶16. (C) The BRV's response to the problem has been somewhat schizophrenic. On the one hand, PDVSA has loaned CP pipe in order for it to continue drilling. However, Seniat, the tax authority, has blocked the sailing of a CP supply vessel that is vital to Corocoro operations.

VERY UNHAPPY CHINESE

¶17. (SBU) The MEP announced on September 25 that it was terminating the production of Orimulsion, a mixture of extra heavy crude oil, water, and chemicals that is used for power plant fuel. Sinovensa, a partnership between PDVSA and CNPC, will cease production on December 31. Sinovensa will be converted into a joint venture that will produce a mixture of extra heavy and lighter crudes. CNPC was constructing an Orimulsion plant as part of its investment in Sinovensa. It also appears to have built a desalting and dehydration plant. It is not clear what will happen to these facilities.

¶18. (C) Lyons stated he recently had a meeting with Chinese executives including a CNPC executive. He stated he was shocked at the vehemence of the executives' complaints regarding the BRV and PDVSA. The CNPC executive complained that major investments were made in Chinese power plants in order to enable them to use Orimulsion. Lyons said one of the executives ended the meeting by stating CP and the Chinese companies had to work together in order to "fight" the Venezuelan government. (COMMENT: Given CNPC's recent labor and tax problems as well as the less than successful migration of its operating service agreement to a joint venture (Reftels C and D), it is little wonder that the BRV's cavalier decision to end the production of Orimulsion has infuriated CNPC executives. Shortly after the Orimulsion announcement, CNPC America President Gong Xun Lu was transferred back to Beijing. END COMMENT)

BROWNFIELD